



February 6, 2023

VIA ELECTRONIC FILING

Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

**RE: Principles for Climate-Related Financial Risk Management for Large Financial Institutions**  
**Attention: Docket ID OP-1793**

To whom it may concern,

Americans for Financial Reform Education Fund (AFREF) welcomes the opportunity to comment on the Board of Governors of the Federal Reserve System's ("Board") Principles for Climate-Related Financial Risk Management for Large Financial Institutions ("principles"). We support this important step toward addressing climate-related financial risk in the banking system and encourage the Board, alongside the other banking regulators, to strengthen and finalize this guidance as soon as possible.

In addition to this submission, AFREF has joined two other comments submitted to the Board that focus on aligning banks' climate commitments with internal strategies and governance, and fair lending, racial justice, and community development implications of the guidance. In this comment, we expand on the views of AFREF and make additional recommendations.

**The Board should acknowledge that net zero transition plans and financed greenhouse gas emissions accounting and disclosure are essential risk management tools for large banks.**

In recent years, many of the largest U.S. banks have developed net zero emissions commitments<sup>1</sup> in recognition of the growing physical and transition risks that financed greenhouse gas (GHG) emissions pose to their businesses, including through the traditional channels of credit risk, market risk, litigation risk, and reputational risk.<sup>2</sup> [The Partnership for](#)

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<sup>1</sup> Forbes, "Big Banks Are Making Big Climate Promises. 3 Ways to Tell Who Will Deliver," 20 Jan 2022, <https://www.forbes.com/sites/edfenergyexchange/2022/01/20/3-climate-actions-banks-must-take-to-fast-track-net-zero-in-2022/?sh=5b1977595ff8>

<sup>2</sup> NGO Letter to US Banking Regulators, "Bank Supervision and Climate Risk," Sept 2021. <https://ourfinancialsecurity.org/wp-content/uploads/2021/09/Supervision-and-Climate-Risk-Documents.pdf>

[Carbon Accounting Financials \(PCAF\)](#)—now in use by over 200 financial institutions worldwide, many of which are supervised by the Board—offers a reliable accounting framework for banks and other financial institutions to calculate and disclose their financed emissions.

Where data gaps exist, banks may still need more comprehensive, standardized information from operational firms to fully assess financed emissions and other climate risks on their balance sheets. The Securities and Exchange Commission’s climate disclosure rulemaking<sup>3</sup> is a step in the right direction to make climate risk information more standardized, credible, decision-useful, and freely available to banks, investors, and other market participants. As it becomes available, bank examiners should work with banks to integrate this new information into their risk management processes and strategies.

Further, as financed GHG emissions are a critical driver of both micro- and macroprudential climate-related risk, the Board should make clear that having a credible transition plan and reporting on progress is a crucial part of a bank’s risk management system. The Board should work with banks to develop credible climate strategies and ensure that their public climate commitments are fully aligned with their internal risk management, strategy, and governance.

**The Board should closely monitor how banks are relying on climate-related financial products and markets within the context of net zero transition plans—and otherwise for risk management—and investigate the integrity problems within these markets.**

The Board should research the use and impacts of climate-related hedging products in collaboration with the CFTC, the other banking regulators, and the Financial Stability Oversight Council (FSOC) to better understand the potential microprudential and macroprudential implications. The Board should provide guidance to ensure that bank risk mitigation strategies are viable, credible, and do not contribute to untenable systemic risk or worsening of the climate crisis and the resultant worsening safety and soundness concerns.

The Commodity Futures Trading Commission (CFTC) Market Risk Advisory Committee recommended in 2020 that “CFTC should coordinate with other regulators to support the development of a robust ecosystem of climate-related risk management products.”<sup>4</sup> Products such as catastrophe bonds, weather derivatives, carbon offsets, and water futures may provide varying degrees of protection, but serious integrity problems within many of these markets call into question their viable use for risk management, and further, these products may contribute to the growth of systemic climate risk that harms the financial system, consumers, and the broader economy.<sup>5</sup>

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<sup>3</sup> SEC, “SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors,” 21 Mar 2022. <https://www.sec.gov/news/press-release/2022-46>

<sup>4</sup> CFTC, “Managing Climate Risk in the U.S. Financial System,” Sept 2020. <https://www.cftc.gov/PressRoom/PressReleases/8234-20>

<sup>5</sup> See E.g. Bloomberg, “Wall Street’s Favorite Climate Solution is Mired in Disagreements,” June 2021. <https://www.bloomberg.com/news/features/2021-06-02/carbon-offsets-new-100-billion-market-faces-disputes-over-trading-rules?sref=f7rH2jWS>; “Letters to Regulators: CFTC Must Address Climate Risk, Carbon

Concerns about transparency, credibility, greenwashing, and environmental injustice in the voluntary carbon offsets and derivatives markets are particularly well-founded and will require significant oversight and regulation to prevent fraudulent and misleading claims, market manipulation, and undisclosed financial risk. Carbon offsets, credits, and derivative products are commonly invoked within net zero transition plans, [but credibility problems persist](#) that may rise to the level of misleading claims, market manipulation, and outright fraud. Recent research suggests that nearly 90 percent of the rainforest offsets certified by the most prominent certifier are worthless and deliver no climate benefits.<sup>6</sup> Reliance on these products is thus in itself risky, and further, may delay emissions reduction investments and progress that is critically needed for systemic risk mitigation. A recent report from the New Climate Institute and Carbon Market Watch analyzed corporate net zero transition plans for 25 companies and found that “Companies’ plans to offset or ‘neutralise’ their emissions are especially contentious.”<sup>7</sup>

**The Board should anticipate the potential impacts of climate supervisory guidance on BIPOC and LMI households and communities and include strong protections and scrutiny regarding adherence to fair lending principles.**

The Board must ensure that financial institutions carefully consider the potential impacts of climate-related financial risks and risk management in the context of racial, economic, environmental, and climate justice and the financial institutions’ obligations under the Fair Housing Act, the Equal Credit Opportunity Act, the Community Reinvestment Act, and the Board’s own obligation under the Fair Housing Act to affirmatively further fair housing. The Board must consider how climate risk guidance will interact with fair lending principles and regulation and consumer financial protections, and how banks can leverage newly available resources—like those authorized by the Inflation Reduction Act<sup>8</sup>—to fairly and equitably manage climate risk. In an effort to remain safe and sound, it is critical that larger, more diversified banks

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Offsets,” Americans for Financial Reform Education Fund. November 7, 2022.

<https://ourfinancialsecurity.org/2022/11/letters-to-regulators-cftc-must-address-climate-risk-carbon-offsets/>

<sup>6</sup> The Guardian, “Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows,” 18 Jan 2023.

<https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe>

<sup>7</sup> New Climate Institute and Carbon Market Watch, *Corporate Climate Responsibility Monitor 2022*, [https://carbonmarketwatch.org/wp-content/uploads/2022/02/CMW\\_CCRM2022\\_v08\\_FinalStretch2.pdf](https://carbonmarketwatch.org/wp-content/uploads/2022/02/CMW_CCRM2022_v08_FinalStretch2.pdf) “19 of the 25 companies assessed already know that they will rely on offsetting for their future pledges, and only one company plans explicitly without offsets (see Figure S3). At least two-thirds of these companies rely on carbon dioxide removals from forestry and other biological-related carbon sequestration (nature-based solutions) to claim that their emissions in the future are offset, i.e. that the impact to the climate is the same as if the emissions were never released in the first place. But these approaches are unsuitable for individual offsetting claims, because biological carbon storage can be reversed (e.g. when forests are cut and burned) and because there is a global requirement to reduce emissions and increase carbon storage, not one or the other. Claims of carbon neutrality today are often misleading; we identified significant credibility problems with all of the carbon neutrality claims from the companies assessed in this report, due to a combination of limited emissions coverage, inconsistent messaging, or procurement of low-quality carbon credits.”

<sup>8</sup> H.R.5376 - Inflation Reduction Act of 2022.

<https://www.congress.gov/bill/117th-congress/house-bill/5376/text>

do not retreat from climate-vulnerable communities, but instead find ways to promote climate resilience for their customers and communities.

AFREF's full views on the fair lending, racial and economic justice, and community development implications of these supervisory guidance principles can be found in the coalition comment submitted on February 6, 2023 alongside 24 other organizations.

**Supervision should encourage banks to obtain additional information from their borrowers and other counterparties related to physical and transition risks.**

These data should include:

- Scopes 1, 2, and 3 GHG emissions data;
- Information on planned capital expenditures on sustainable products and initiatives and their likely impact on company emissions, energy, and natural resource use, as well as transition plans;
- Geolocational information of all critical borrower infrastructure;
- Borrower climate disclosures prepared using the TCFD framework (banks should encourage borrowers to disclose this information using the TCFD framework to ensure that climate-relevant data is comparable across industries and geographies); and
- Information about corporate impacts and track record on environmental justice, Indigenous rights, land use, natural resources, public health, local economies, and other community-level impacts.<sup>9</sup>

**Existing regulatory reporting requirements should be expanded to better capture banks' exposure to assets with high levels of physical and/or transition risk.**

We recommend that reporting requirements be expanded to include a series of line items to each applicable schedule about loans for fossil fuel exploration, production, and fossil electricity generation, as well as securities backed by these assets and derivatives referencing them. As with real estate lending on the current call reports, these loans should be broken out by duration, with detailed information about allowances for losses on loans with terms of three or more years, which are particularly exposed to transition risk. The call reports should also add additional information about the exposure of existing loan types to physical risks, such as separate line items for loans and asset-backed securities secured by real estate in flood zones or high wildfire risk areas.

**The Board should continue to work with banks to conduct rigorous climate scenario exercises, analyze the results, and develop strategies to manage identified risks.**

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<sup>9</sup> Submitted comments to the SEC on climate-related disclosures and community impacts. June 2022. <https://oceanconservancy.org/wp-content/uploads/2022/06/EJ-Comment-Letter-June16-9am.pdf>; <https://amazonwatch.org/assets/files/2022-06-16-sec-comment-letter.pdf>; [https://ourfinancialsecurity.org/wp-content/uploads/2022/06/Retail-Survey-Results-Comment\\_AFR-PC\\_S-EC-Climate-Disclosure\\_06-16-2022.pdf](https://ourfinancialsecurity.org/wp-content/uploads/2022/06/Retail-Survey-Results-Comment_AFR-PC_S-EC-Climate-Disclosure_06-16-2022.pdf)

The Board should build on their first round of scenario analysis exercises by strengthening the climate scenarios themselves and working with all large banks to run them and mitigate identified risks in a safe and orderly manner before physical impacts and transition shocks become unmanageable. Climate scenarios should include ambitious energy transition scenarios like the International Energy Agency's Net Zero by 2050 scenario,<sup>10</sup> incorporate best practices as developed by the Network for Greening the Financial System (NGFS) and rigorous central bank exercises.<sup>11</sup> Climate scenarios should also include orderly and disorderly transitions coinciding with a broad range of *extreme but plausible* outcomes with respect to global emissions, climate sensitivity, tipping points, and speed of the energy transition. These exercises should be used to determine breaking points for bank solvency. Thus, models should be analytical, not discrete, to allow for a robust assessment of the risk landscape across many parameters and for a full range of extreme but plausible circumstances.

Rigorous climate scenario analysis exercises must also embed the following principles:

- 1) **Banks cannot rely on historical data** to measure forward-looking physical risk from climate change. Over the past four decades, the intensity, frequency and economic impacts of many types of climate disasters have increased nonlinearly,<sup>12</sup> and these effects are expected to continue.<sup>13</sup> Using historical data—even *looking at the most severe events of the past*—does not capture the severity of future storms, which will likely be far more severe and costly.
- 2) **Physical and transition losses will likely be correlated and scenario analysis needs to incorporate shocks in series and in parallel, not as discrete events.** Acute physical damages from climate disasters, chronic losses of productivity due to physical changes, transition shocks, and chronic transition losses and gradual write-offs of stranded assets will occur in parallel, in series, and interdependently. The increased frequency of climate disasters will likely deteriorate the financial resilience of banks and the communities they serve, and whether households and businesses will be able to continually absorb consistently increasing climate-related losses and remain solvent must be carefully investigated.
- 3) **Scenario analysis must explore network effects within the financial sector.** The financial sector's response to climate disasters or transition shocks may include contagion, bank runs, rapid asset repricing, credit deterioration, and other network

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<sup>10</sup> IEA, "Net Zero by 2050: A Roadmap for the Global Energy Sector," May 2021.

<https://www.iea.org/reports/net-zero-by-2050>

<sup>11</sup> ECB, "ECB economy-wide climate stress test: Methodology and results," Sept 2021.

<https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op281~05a7735b1c.en.pdf>

<sup>12</sup> NOAA, "United States Billion-Dollar Disaster Events 1980-2021 (CPI-Adjusted),"

<https://www.ncdc.noaa.gov/billions/time-series>

<sup>13</sup> Swiss Re Institute, "World economy set to lose up to 18% GDP from climate change if no action taken, reveals Swiss Re Institute's stress-test analysis," 22 Apr 2021.

<https://www.swissre.com/media/news-releases/nr-20210422-economics-of-climate-change-risks.html>

effects that lead to further financial instability. Modeling that doesn't include network effects will likely underestimate the threat of climate change to financial stability.

**The Fed, along with the other banking regulators, should extend and tailor these supervisory principles for banks of all sizes.**

The Fed draft notes that “all financial institutions, regardless of size, may have material exposures to climate-related financial risks.” We agree, and encourage the Board, in collaboration with other banking regulators, to extend and tailor their supervisory guidance to banks of all sizes, including smaller institutions which may be more vulnerable to climate risk than larger banks due to the financial needs they meet and their more limited geographic range and product offerings. For instance, a bank may have branches concentrated in an area which experiences frequent floods, hurricanes, or wildfires and thus has disproportionately high physical risk, or a bank may have excessive transition risk if its portfolio is heavy in fossil fuel or other carbon-intensive assets.

It is also critical that supervisory expectations encourage enhanced operational resilience to climate risks—especially for smaller institutions that provide vital banking services to underserved communities during and following disasters and other times of acute need—and that risk mitigation strategies broadly remedy rather than exacerbate economic burdens on lower income communities and communities of color. Tailored guidance based on location and business model should also be a component of Fed's supervisory and examinations process.

We thank the Board for moving forward with supervisory guidance to better understand and mitigate climate-related financial risk within the banking system. We urge you to issue final climate risk principles with the other federal banking regulators as soon as possible, as the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation have already collected extensive comments on nearly the exact same principles since they were first issued in December 2021. Incorporating climate risk into bank supervision alongside all other risk types is an urgent task that must commence quickly to protect consumers and the financial system. For more information please contact Alex Martin ([alex@ourfinancialsecurity.org](mailto:alex@ourfinancialsecurity.org)).

Sincerely,

Americans for Financial Reform Education Fund